



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Region IX
Office of Audit Services
50 United Nations Plaza, Room 171
San Francisco, CA 94102

March 23, 2007

Report Number: A-09-05-00057

Ms. Sandra Shewry
Director
Department of Health Services
1501 Capitol Avenue, MS 0000
P.O. Box 997413
Sacramento, California 95899-7413

Dear Ms. Shewry:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG) final report entitled "Review of California's Controls Over Reporting of County Medicaid Administrative Expenditures." A copy of this report will be forwarded to the action official noted on the following page for review and any action deemed necessary.

The HHS action official will make final determination as to actions taken on all matters reported. We request that you respond to the HHS action official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

In accordance with the principles of the Freedom of Information Act, 5 U.S.C. § 552, as amended by Public Law 104-231, OIG reports issued to the Department's grantees and contractors are made available to the public to the extent the information is not subject to exemptions in the Act that the Department chooses to exercise (see 45 CFR part 5).

Please refer to report number A-09-05-00057 in all correspondence.

Sincerely,

A handwritten signature in black ink, appearing to read "Lori A. Ahlstrand", is written over a horizontal line.

Lori A. Ahlstrand
Regional Inspector General
for Audit Services

Enclosures

Direct Reply to HHS Action Official:

Ms. Linda Minamoto
Associate Regional Administrator
Division of Medicaid & Children's Health
Centers for Medicare & Medicaid Services, Region IX
90 Seventh Street, Suite 5-300 (5W)
San Francisco, California 94103

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF CALIFORNIA'S
CONTROLS OVER
REPORTING OF COUNTY
MEDICAID ADMINISTRATIVE
EXPENDITURES**



**Daniel R. Levinson
Inspector General**

**March 2007
A-09-05-00057**

Office of Inspector General

<http://oig.hhs.gov>

The mission of the Office of Inspector General (OIG), as mandated by Public Law 95-452, as amended, is to protect the integrity of the Department of Health and Human Services (HHS) programs, as well as the health and welfare of beneficiaries served by those programs. This statutory mission is carried out through a nationwide network of audits, investigations, and inspections conducted by the following operating components:

Office of Audit Services

The Office of Audit Services (OAS) provides all auditing services for HHS, either by conducting audits with its own audit resources or by overseeing audit work done by others. Audits examine the performance of HHS programs and/or its grantees and contractors in carrying out their respective responsibilities and are intended to provide independent assessments of HHS programs and operations. These assessments help reduce waste, abuse, and mismanagement and promote economy and efficiency throughout HHS.

Office of Evaluation and Inspections

The Office of Evaluation and Inspections (OEI) conducts national evaluations to provide HHS, Congress, and the public with timely, useful, and reliable information on significant issues. Specifically, these evaluations focus on preventing fraud, waste, or abuse and promoting economy, efficiency, and effectiveness in departmental programs. To promote impact, the reports also present practical recommendations for improving program operations.

Office of Investigations

The Office of Investigations (OI) conducts criminal, civil, and administrative investigations of allegations of wrongdoing in HHS programs or to HHS beneficiaries and of unjust enrichment by providers. The investigative efforts of OI lead to criminal convictions, administrative sanctions, or civil monetary penalties.

Office of Counsel to the Inspector General

The Office of Counsel to the Inspector General (OCIG) provides general legal services to OIG, rendering advice and opinions on HHS programs and operations and providing all legal support in OIG's internal operations. OCIG imposes program exclusions and civil monetary penalties on health care providers and litigates those actions within HHS. OCIG also represents OIG in the global settlement of cases arising under the Civil False Claims Act, develops and monitors corporate integrity agreements, develops compliance program guidances, renders advisory opinions on OIG sanctions to the health care community, and issues fraud alerts and other industry guidance.

Notices

THIS REPORT IS AVAILABLE TO THE PUBLIC
at <http://oig.hhs.gov>

In accordance with the principles of the Freedom of Information Act (5 U.S.C. 552, as amended by Public Law 104-231), Office of Inspector General, Office of Audit Services reports are made available to members of the public to the extent the information is not subject to exemptions in the act. (See 45 CFR Part 5.)

OAS FINDINGS AND OPINIONS

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of the HHS/OIG/OAS. Authorized officials of the HHS divisions will make final determination on these matters.

EXECUTIVE SUMMARY

BACKGROUND

The Centers for Medicare & Medicaid Services (CMS) requested that we review the State of California's internal controls over reporting of its 58 counties' (the counties) Medicaid administrative expenditures.

Medicaid is a jointly funded Federal and State program that provides medical assistance to low-income people who qualify under Title XIX of the Social Security Act. Federal regulations require States to report Medicaid expenditures for medical assistance and administrative costs to CMS. Federal regulations also require States to maintain accounting systems and supporting fiscal records to ensure that claims for Federal funds meet applicable Federal requirements.

In California, the Department of Health Services (the State agency) administers the Medicaid program with Federal oversight from CMS. The State agency administers some components of Medicaid through other State departments. For example, the Department of Social Services administers eligibility determinations and personal care services through county welfare agencies. The State agency reported Medicaid expenditures of over \$33.8 billion (\$17.1 billion Federal share) for Federal fiscal year 2005 (October 1, 2004, through September 30, 2005). These expenditures included over \$3.1 billion (\$1.6 billion Federal share) of county administrative expenditures.

The Department of Social Services provides an electronic "County Expense Claim" (expense claim) template program for the counties to use in classifying, allocating, and reporting quarterly expenditures for various programs, including Medicaid eligibility determinations and personal care services. The Department of Social Services maintains and updates the template and forwards the reported Medicaid administrative expenditures to the State agency for inclusion on Form CMS-64.

OBJECTIVE

Our objective was to evaluate the adequacy of the State agency's financial and compliance controls over reporting of the counties' Medicaid administrative expenditures.

SUMMARY OF FINDINGS

We identified weaknesses in the State agency's financial and compliance controls over reporting of the counties' Medicaid administrative expenditures. Specifically, the State agency did not have adequate financial controls to ensure that:

- the counties' Medicaid expenditures reported on the expense claim were allowable for Federal reimbursement and
- coding instructions in and changes made to the expense claim template were reviewed for accuracy and compliance with Medicaid requirements.

In addition, the State agency did not have a compliance control to ensure that it established a written agreement with the Department of Social Services detailing their relationship and respective responsibilities for gathering, reviewing, and reporting the counties' Medicaid expenditures for eligibility determinations, as required by Federal regulations. We found that an agreement existed for personal care services.

RECOMMENDATIONS

We recommend that the State agency establish financial controls to ensure that it:

- verifies that county Medicaid expenditures reported on the expense claim are allowable for Federal reimbursement and
- reviews coding instructions in and changes made to the expense claim template for accuracy and compliance with Medicaid requirements.

In addition, we recommend that the State agency establish a written agreement with the Department of Social Services detailing their relationship and respective responsibilities for gathering, reviewing, and reporting the counties' expenditures for eligibility determinations.

STATE AGENCY'S COMMENTS

In its comments on our draft report, the State agency agreed with the recommendations and stated that it will implement necessary changes. The full text of the State agency's comments is included as the Appendix.

TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION	1
BACKGROUND	1
Medicaid Overview	1
California Medicaid Program	1
County Expense Claim Template	1
Internal Controls	2
OBJECTIVE, SCOPE, AND METHODOLOGY	2
Objective.....	2
Scope	2
Methodology.....	3
FINDINGS AND RECOMMENDATIONS	3
FINANCIAL CONTROLS.....	4
Federal Regulations	4
Financial Control Needed To Ensure	
Allowability of County Medicaid Expenditures.....	4
Financial Control Needed To Ensure	
Review of Template Coding Instructions.....	5
COMPLIANCE CONTROL	5
Written Agreement Needed With Department of Social Services	5
RECOMMENDATIONS.....	6
STATE AGENCY’S COMMENTS.....	6
 APPENDIX	
STATE AGENCY’S COMMENTS	

INTRODUCTION

BACKGROUND

The Centers for Medicare & Medicaid Services (CMS) requested that we review the State of California's internal controls over reporting of its 58 counties' (the counties) Medicaid administrative expenditures.

Medicaid Overview

Medicaid is a jointly funded Federal and State program that provides medical assistance to low-income people who qualify under Title XIX of the Social Security Act (the Act). Federal regulations require States to report Medicaid expenditures for medical assistance and administrative costs on the "Quarterly Medicaid Statement of Expenditures for the Medical Assistance Program," Form CMS-64 (CMS-64).

The Federal Government pays its share of expenditures according to a formula defined in section 1905(b) of the Act. The Federal share is determined using the Federal medical assistance percentage (FMAP). For administrative expenditures, the FMAP ranges from 50 percent to 100 percent, depending on the type of expenditure.

Federal regulations require States to maintain accounting systems and supporting fiscal records to ensure that claims for Federal funds meet applicable Federal requirements.

California Medicaid Program

In California, the Department of Health Services (the State agency) administers the Medicaid program with Federal oversight from CMS.¹ The State agency administers some components of Medicaid through other State departments. For example, the Department of Social Services administers eligibility determinations and personal care services through county welfare agencies. County social workers determine eligibility for Medicaid services and authorize needed personal care services, such as providing assistance with personal hygiene.

The State agency reported Medicaid expenditures of over \$33.8 billion (\$17.1 billion Federal share) for Federal fiscal year 2005 (October 1, 2004, through September 30, 2005). These expenditures included over \$3.1 billion (\$1.6 billion Federal share) of county administrative expenditures.

County Expense Claim Template

The Department of Social Services provides an electronic "County Expense Claim" (expense claim) template program for the counties to use in classifying, allocating, and reporting quarterly expenditures for various programs, including Medicaid eligibility determinations and personal care services. The Department of Social Services maintains and updates the template and forwards the reported Medicaid administrative expenditures to the State agency for inclusion on the CMS-64.

¹In California, Medicaid is referred to as Medi-Cal.

For the quarter ended December 31, 2004 (the December quarter), the State agency reported expenditures of about \$554.2 million for eligibility determinations and personal care activities. These expenditures accounted for about 82 percent of the counties' total Medicaid administrative expenditures reported on the CMS-64 for the December quarter.

Internal Controls

Both the Federal regulations (42 CFR § 433.32 and 45 CFR § 92.20) and California law (Government Code 13402) require that internal controls be an integral component of an organization's management. The controls should provide reasonable assurance that the following objectives are achieved:

- reliability of financial reporting (financial controls),
- compliance with applicable laws and regulations (compliance controls), and
- effectiveness and efficiency of operations.

The State agency is responsible for establishing and maintaining internal controls over the State Medicaid program. To fulfill this responsibility, the State agency is required to make estimates and judgments to assess the expected benefits and related costs of internal policies and procedures. Because of the inherent limitations of any internal control, errors and irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of internal controls to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to evaluate the adequacy of the State agency's financial and compliance controls over reporting of the counties' Medicaid administrative expenditures.

Scope

We reviewed the adequacy of the State agency's financial and compliance controls over reporting of the counties' Medicaid administrative expenditures. We did not review the State agency's controls over effectiveness and efficiency of Medicaid operations.

We conducted fieldwork at the State agency, the Department of Social Services, and the State Controller's Office in Sacramento, California, and at the San Diego County Health and Human Services Agency (San Diego County) in San Diego, California.

Methodology

To accomplish our objective, we:

- reviewed Titles 42 and 45 of Federal regulations, Office of Management and Budget (OMB) Circular A-87, Government Accountability Office (GAO) “Standards for Internal Control in the Federal Government” (GAO/AIMD-00-21.3.1, November 1999), and CMS’s “State Medicaid Manual”;
- obtained and analyzed documentation of the State agency’s and the Department of Social Services’s processes for gathering and reviewing county Medicaid administrative expenditures and the State agency’s process for reporting them to CMS;
- obtained and analyzed documentation of San Diego County’s processes for reporting Medicaid administrative expenditures through the Department of Social Services to the State agency;
- interviewed CMS Region IX staff and both California and San Diego County officials; and
- tested selected transactions supporting administrative expenditures that the State agency reported for the two largest Medicaid administrative activities, eligibility determination and personal care services, on the expense claim for the December quarter.

We conducted the audit in accordance with generally accepted government auditing standards.

FINDINGS AND RECOMMENDATIONS

We identified weaknesses in the State agency’s financial and compliance controls over reporting of the counties’ Medicaid administrative expenditures. Specifically, the State agency did not have adequate financial controls to ensure that:

- the counties’ Medicaid expenditures reported on the expense claim were allowable for Federal reimbursement and
- coding instructions in and changes made to the expense claim template were reviewed for accuracy and compliance with Medicaid requirements.

In addition, the State agency did not have a compliance control to ensure that it established a written agreement with the Department of Social Services detailing their relationship and respective responsibilities for gathering, reviewing, and reporting the counties’ Medicaid expenditures for eligibility determinations, as required by Federal regulations. We found that an agreement existed for personal care services.

FINANCIAL CONTROLS

The State agency did not have adequate financial controls to ensure that (1) the counties' Medicaid expenditures reported on the expense claim were allowable for Federal reimbursement and (2) coding instructions in and changes made to the expense claim template were reviewed for accuracy and compliance with Medicaid requirements.

Federal Regulations

Federal regulations (42 CFR § 433.32) require that the State agency “. . . (a) Maintain an accounting system and supporting fiscal records to assure that claims [reported on the CMS-64] for Federal funds are in accord with applicable Federal requirements. . . .” Federal regulations (45 CFR § 92.20(a)) also state: “. . . Fiscal control and accounting procedures of the State, as well as its subgrantees . . . must be sufficient to . . . establish that such [Medicaid] funds have not been used in violation of the restrictions and prohibitions of applicable statutes.”

OMB Circular A-87, Attachment A, section A.2.a.(2), states: “Governmental units assume responsibility for administering Federal funds in a manner consistent with underlying agreements, program objectives, and the terms and conditions of the Federal award [Medicaid program].” Attachment B of the Circular provides principles to be applied in determining allowable or unallowable costs for Federal awards.

Financial Control Needed To Ensure Allowability of County Medicaid Expenditures

The State agency did not have a financial control to verify that the counties' Medicaid expenditures reported on the expense claim were allowable for Federal reimbursement. Acting on behalf of the State agency, the Department of Social Services relied solely on the counties' certifications for determining the allowability of the expenditures for Federal reimbursement.

Although the Department of Social Services analyzes the reported expenditures for consistency with previously approved budgeted amounts and countywide cost allocation plans, this review does not verify whether the reported expenditures are allowable. Neither the State agency nor the Department of Social Services was able to identify any control activity² to substantiate that county administrative expenditures reported on the quarterly expense claims were allowable. For example, San Diego County expense claims were not reviewed for unallowable salary and benefit costs. However, San Diego County on its own initiative identified and excluded unallowable supply and material costs from the expense claim. The State agency did not have a control to ensure the allowability of the costs claimed or a requirement that the counties have such a control.

²Page 11 of GAO's Standards for Internal Control in the Federal Government” states: “Control activities occur at all levels and functions of the entity. They include a wide range of diverse activities such as approvals, authorizations, verifications, reconciliations . . . and the creation and maintenance of related records which provide evidence of execution of these activities as well as appropriate documentation.”

Our review of several county certifications of the quarterly expense claims showed that the county welfare directors' certifications were limited to Federal requirements related to compliance with Federal lobbying restrictions and Governmentwide debarment and suspension. The county welfare directors' certifications also addressed State requirements that did not pertain to ensuring that reported expenditures complied with Medicaid requirements. In addition, the county auditors' certifications were limited to the same three requirements reviewed by the county welfare directors.

State officials believed that the certification statements signed by county officials were a sufficient control. Without a control activity for reviewing the allowability of costs on the expense claim, there was no reasonable assurance that the counties' reported Medicaid administrative expenditures complied with Medicaid requirements.

Financial Control Needed To Ensure Review of Template Coding Instructions

The State agency did not have a financial control to ensure that coding instructions in and changes made to the expense claim template by the Department of Social Services were reviewed for accuracy and compliance with Medicaid requirements. The template program included instructions and changes made by a single Department of Social Services' employee. The template was used to classify and allocate county Medicaid administrative expenditures, which were forwarded to the State agency for inclusion on the CMS-64. There were no reviews of the program coding instructions or changes made to the template by supervisory staff of the Department of Social Services or the State agency. Without a control activity for reviewing template coding instructions, there was no reasonable assurance that the counties' reported Medicaid administrative expenditures were calculated correctly and complied with Medicaid requirements.

COMPLIANCE CONTROL

Written Agreement Needed With Department of Social Services

Federal regulations (42 CFR § 431.10 (d)) state: "... The [State Medicaid] plan must provide for written agreements between the Medicaid agency [State agency] and the Federal or other State agencies that determine eligibility for Medicaid, stating the relationships and respective responsibilities of the agencies."

Contrary to Federal regulations and California's State plan, the State agency did not have a written agreement with the Department of Social Services, stating their relationship and respective responsibilities for gathering, reviewing, and reporting the counties' Medicaid expenditures for eligibility determinations. State agency and Department of Social Services officials did not believe a written agreement was necessary. However, they stated that an agreement would be established if required by Federal regulations. Without a written agreement, there was no reasonable assurance that the State agency, as the single agency responsible for the Medicaid program, exercised adequate oversight over reporting of expenditures for the counties' eligibility determination activities.

RECOMMENDATIONS

We recommend that the State agency establish financial controls to ensure that it:

- verifies that county Medicaid expenditures reported on the expense claim are allowable for Federal reimbursement and
- reviews coding instructions in and changes made to the expense claim template for accuracy and compliance with Medicaid requirements.

In addition, we recommend that the State agency establish a written agreement with the Department of Social Services detailing their relationship and respective responsibilities for gathering, reviewing, and reporting the counties' Medicaid expenditures for eligibility determinations.

STATE AGENCY'S COMMENTS

In its comments on our draft report, the State agency agreed with the recommendations and stated that it will implement necessary changes. The full text of the State agency's comments is included as the Appendix.

APPENDIX



State of California—Health and Human Services Agency
Department of Health Services



ARNOLD SCHWARZENEGGER
Governor

FEB 14 2007

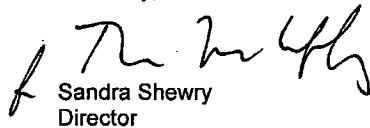
Lori A. Ahlstrand
Centers for Medicare and Medicaid Services
Regional Inspector General For Audit Services
Office of Inspector General
50 United Nations Plaza
San Francisco, CA 94102

Dear Ms. Ahlstrand:

The California Department of Health Services (CDHS) has prepared its response to the Office of Inspector General's (OIG) draft report entitled "Review of California's Controls Over County Medicaid Administrative Expenditures." The CDHS appreciates the work performed by the OIG and the opportunity to respond to the draft report.

Please contact Mr. Mark Hutchinson, Deputy Director, Administration, at (916) 440-7525 if you have any questions.

Sincerely,



Sandra Shewry
Director

Enclosure

cc: See next page

Lori A. Ahlstrand

Page 2

FEB 14 2007

cc: Mark Hutchinson
Deputy Director
Administration
1501 Capitol Avenue, MS 1000
P.O. Box 997413
Sacramento, CA 95899-7413

Stan Rosenstein
Deputy Director
Medical Care Services
1501 Capitol Avenue, MS 4000
P.O. Box 997413
Sacramento, CA 95899-7413

Melody Pang
External Audits Coordinator
Department of Social Services
744 P Street, 7-192
Sacramento, CA 95814

California Department of Health Services Response to the
Office of Inspector General's Draft Report

"Review of California's Controls Over County
Medicaid Administrative Expenditures"

The Centers for Medicare and Medicaid Services (CMS) requested that the Office of Inspector General (OIG) review the State of California's internal controls over reporting of its 58 counties' Medicaid administrative expenditures. In California, the California Department of Health Services (CDHS) administers the Medicaid program with Federal oversight from CMS. CDHS administers some components of Medicaid through other State departments, for example, the California Department of Social Services (CDSS). CDSS provides an electronic "County Expense Claim" for the counties to report quarterly expenditures related to Medicaid Eligibility determinations and personal care services. The purpose of the OIG review was to evaluate the adequacy of CDHS financial and compliance controls over the reporting of Medicaid administrative expenditures and assess the relationship between CDHS and CDSS in relation to this process.

The OIG draft report entitled "Review of California's Controls Over County Medicaid Administrative Expenditures" (see attached report for details) did not have any fiscal findings. It did, however, identify weaknesses in the CDHS financial and compliance controls over reporting of the counties' Medicaid administrative expenditures.

Specifically, the report found that CDHS did not have adequate financial controls to ensure that:

- The counties' Medicaid expenditures reported on the expense claim were allowable for Federal reimbursement and
- Coding instructions in and changes made to the County Expense Claim were reviewed for accuracy and compliance with Medicaid requirements.

In addition, CDHS did not have a written agreement with CDSS detailing their relationship and respective responsibilities for gathering, reviewing, and reporting the counties' Medicaid expenditures for eligibility determinations, as required by Federal regulations.

CDHS and CDSS reviewed the recommendations made by the OIG. The decision was made to prepare a joint response. Both CDHS and CDSS concur with the OIG recommendations and will implement necessary changes as discussed on the following page.

**California Department of Health Services Response to the
Office of Inspector General's Draft Report**

**"Review of California's Controls Over County
Medicaid Administrative Expenditures"**

Recommendations and Responses:

1. Recommendation:

CDHS should establish financial controls to ensure that Medicaid expenditures reported on the County Expense Claim are allowable for Federal reimbursement.

Response:

CDHS has hired two staff for this purpose. On-site county reviews will be conducted beginning in February 2007 to verify Medicaid expenditures as reported on the County Expense Claims to ensure they are allowable for Federal reimbursement.

2. Recommendation:

CDHS should establish financial controls to ensure that it (CDHS) reviews coding instructions in and changes made to the County Expense Claim for accuracy and compliance with Medicaid requirements.

Response:

CDHS will review all current instructions issued by CDSS relating to the claiming of Medicaid expenditures on the County Expense Claim to ensure compliance with Medicaid requirements. This will be completed by May 1, 2007. In the future, CDHS will be part of the review and approval process for changes made to these instructions. Additionally, CDHS is currently working with CDSS in a review of county time-study code definitions to ensure activities described for Title XIX reimbursement are in compliance with Title XIX regulations. A Memorandum of Understanding (MOU) will be developed between CDSS and CDHS to address this process (see Response #3).

3. Recommendation:

CDHS should establish a written agreement with CDSS detailing their relationship and respective responsibilities for gathering, reviewing, and reporting the counties' Medicaid expenditures for eligibility determinations.

**California Department of Health Services Response to the
Office of Inspector General's Draft Report**

**"Review of California's Controls Over County
Medicaid Administrative Expenditures"**

Response:

CDHS and CDSS will enter into a MOU to identify their relationship, roles, and responsibilities by July 1, 2007, as it relates to the reviewing and reporting of Medicaid expenditures for eligibility determinations. In addition, this MOU will detail the process to be used to ensure CDHS participation in the expenditure claiming process and audit reviews, as they affect Medicaid.